Briefing Paper

1. The combination of industry pricing practices of reducing the gap thereby compressing the branded generic or middle tier <u>and</u> a dramatic increase in the number of trademarks in the sub-generic category will accelerate the collapse of the middle tier and the emergence of a new price point below the current sub-generic level. Indeed, a Doral price reduction is possible in 1991 and should RJR take such an action we can, with a high degree of certainty, predict the following:

   A. The need to reduce the MLP of Cambridge <u>or</u> accept risk of irreparable harm to that franchise.

   B. An incidence of couponing at lower denominations equal to current branded generic levels (60%+).

   C. The small four companies in seeking a point of differentiation with Magna, Sterling, Doral, Bristol, Cambridge and Alpine move to a new price point. Its worth noting that after the anticipated mid-year pricing actions, a manufacturer's list price of $22.50/M offers a new price tier differential of $2.50 per carton, the historic threshold for new price points.

2. The sub-generic category's strength continues to evolve in the pack environment. Pack price reduction has been the Achilles' heel of the branded generic category. It is simply not possible to apply traditional price subsidy tools to packs beyond nominal levels. By delivering low net cost to pack consumers through list price, sub-generics become the pack proposition of choice. In other words, retailers can deliver and advertise savings in packs unencumbered by limiting these savings to "while supplies last".

3. Currently, sub-generics are capable of delivering higher <u>net</u> contributions than branded generics. In first revised, Bristol's net contribution is $10.07/M vs Cambridge $9.15/M. However, as the category becomes more crowded, net profitability is likely to be eroded by higher DME as the number of entries outpaces the category's growth and each brand subsequently increases promotional support.

4. Among the carton trade classes, especially chain supermarkets and mass merchandisers, there is inadequate retail capacity to sustain distribution of both Bristol and Cambridge. The average number of rows will not support both brands without excessive OOS's. Therefore a Bristol expansion as a response to the Magna/Sterling action will necessitate:

   a. The cannibalization of Cambridge rows
   b. The cannibalization of full margin rows
   c. A significant payment premium for incremental rows

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5. It is possible that RJR's fundamental strategy in the recent action is to cause disruption in the Marlboro franchise <u>even</u> at the risk of their own full margin trademarks. RJR's retail position with Doral in supermarkets and Camel and Magna's appeal to the pack purchaser may have caused that company to view all full margin disruption as a positive sum game. Furthermore, it should be noted that RJR's retail presence and generally higher level of promoted volume (Camel) makes that company the probable beneficiary of an escalation in the breakdown of brand loyalty.

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